

Memorandum 2021-5

**Stock Cooperatives and Uniform TOD Security Registration Act:
(Discussion of Issues)**

In this study, the Commission¹ is developing a proposed law that could be used to make a nonprobate transfer on death of a decedent's ownership interest in a stock cooperative.

The ownership of an interest in a stock cooperative is based on the ownership of a share of stock. For that reason, the Commission has looked to the Uniform TOD Security Registration Act² as a possible model for the proposed law. That statute authorizes the registration of securities in transfer on death ("TOD") form. Securities registered in that form pass to a named beneficiary on the registering owner's death, without probate administration.

The Commission has also been using the revocable transfer on death ("RTODD") statute as a model. For many issues addressed by the RTODD statute, an interest in a stock cooperative is not materially different from any other interest in real property. On those issues, the Commission's and the Legislature's policy conclusions regarding the RTODD statute should be given weight in this study. This is especially true where the Legislature enacted a policy choice that is contrary to the Commission's recommendation. On those matters, the clear policy preference of the Legislature should be respected.

This study has been moving progressively through the issues that need to be addressed in developing the proposed law. Most of those issues have already been decided. **This memorandum discusses the last two broad areas that require decisions:**

- (1) Rules for contesting the validity of a registration of a stock cooperative interest in TOD form.

1. Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting. However, comments that are received less than five business days prior to a Commission meeting may be presented without staff analysis.

2. Prob. Code §§ 5500-5512.

- (2) The effect of registration of a stock cooperative interest in TOD form on other instruments and forms of ownership that govern the same property.

Once the Commission has decided how to address those matters, the staff will prepare a draft of a tentative recommendation for the Commission's consideration.

All statutory references in this memorandum are to the Probate Code. For convenience, this memorandum will use the shorthand term "TOD registration" to mean the registration of an interest in a stock cooperative in TOD form.

BACKGROUND

A stock cooperative is an unusual form of common interest development ("CID"), because of the way that an individual interest in the development is held and evidenced. In most CIDs, the individual owners hold exclusive title to a dedicated part of the development (e.g., a unit, lot, or parcel) and a shared interest in common area. Ownership of the individual interest is evidenced and transferred using a deed.

In a stock cooperative, title is held entirely by a corporation that is formed for that purpose. Individual owners do not hold title to any part of the development. Instead, they have a use right. That use right is not evidenced by a deed, but by a share of stock in the corporation that owns the development. There may also be other documents that govern the use right (e.g., a membership agreement, occupancy agreement, or proprietary lease).

As discussed in a prior memorandum,³ when an interest in a stock cooperative is transferred, there may be no recordation of the transferring instrument. This is especially likely in a limited equity housing cooperative, where the price may be low enough to obviate the need for financing. It is also likely where the transfer is donative.

CONTEST

The RTODD statute includes the following provisions, which govern key issues relating to a contest of the validity of an RTODD:

5690. Standing, venue, and lis pendens

5690. (a) (1) An action for the disqualification of a beneficiary under Part 3.7 (commencing with Section 21360) of Division 11 may

3. See Memorandum 2020-69.

be brought to contest the validity of a transfer of property by a revocable transfer on death deed.

(2) An action to contest the validity of a transfer of property by a revocable transfer on death deed may be filed by the transferor's personal representative or an interested person under Part 19 (commencing with Section 850) of Division 2.

(b) The proper county for a contest proceeding is the proper county for proceedings concerning administration of the transferor's estate, whether or not proceedings concerning administration of the transferor's estate have been commenced at the time of the contest.

(c) On commencement of a contest proceeding, the contestant may record a lis pendens in the county in which the revocable transfer on death deed is recorded.

5692. Timing

5692. (a) A contest proceeding pursuant to Section 5690 shall not be commenced before the transferor's death.

(b) For the purposes of the applicable limitations period, a contest proceeding accrues on the date of the transferor's death.

5694. Remedy

5694. If the court in a contest proceeding determines that a transfer of property by a revocable transfer on death deed is invalid, the court shall order the following relief:

(a) If the proceeding was commenced and a lis pendens was recorded within 120 days after the transferor's death, the court shall void the deed and order transfer of the property to the person entitled to it.

(b) If the proceeding was not commenced and a lis pendens was not recorded within 120 days after the transferor's death, the court shall grant appropriate relief but the court order shall not affect the rights in the property of a purchaser or encumbrancer for value and in good faith acquired before commencement of the proceeding and recordation of a lis pendens.

5696. Grounds; action by conservator or guardian

5696. (a) Nothing in this chapter limits the application of principles of fraud, undue influence, duress, mistake, or other invalidating cause to a transfer of property by a revocable transfer on death deed.

(b) Notwithstanding subdivision (a) of Section 5692, the conservator or guardian of a transferor may, before the transferor's death, petition the court for invalidation of a revocable transfer on death deed executed by the transferor.

The effect of those provisions is summarized below:

- The RTODD is subject to general law that establishes a presumption of undue influence or fraud when a donative instrument names a beneficiary in a specified relationship to the instrument or transferor. Section 5690(a)(1).
- The transferor's personal representative and any interested person has standing to contest an RTODD. Section 5690(a)(2).
- Venue for a contest is in the county where the court has jurisdiction to administer the transferor's estate. Section 5690(b).
- A person who files a contest may record a *lis pendens* (notice of the pending court action) in the county where the property is located. Section 5690(c).
- An RTODD contest cannot be commenced during the transferor's life. Section 5692(a).
- Any limitation on the time for commencing a contest begins running on the transferor's death. Section 5692(b).
- If a contest is successful *and a lis pendens was recorded within 120 days of the transferor's death*, the court shall void the deed. Section 5694(a).
- *If a lis pendens is not recorded within 120 days of the transferor's death*, a successful contest cannot disturb any rights of a bona fide purchaser or encumbrancer for value who acquired an interest in the property in good faith and before the contest was commenced and a *lis pendens* was recorded. Section 5694(b).
- The RTODD statute does not affect the availability of other law on the invalidation of an instrument. Section 5696(a).
- During the transferor's life, a conservator or guardian of the transferor can petition the court to invalidate an RTODD. Section 5696(b).

The italics in the two bulletpoints relating to recordation of a *lis pendens* highlight a point that will be important in the discussion of conflicting instruments that follows later in this memorandum.

General Recommendation

The provisions discussed above address important issues in a sensible way. They were carefully thought out by the Commission in the development of its RTODD recommendation. The staff sees no reason why a stock cooperative should be treated differently with regard to such matters, as compared to any other interest in real property that could be conveyed by RTODD.

With the exception discussed below, the staff recommends that contest rules from the RTODD statute be included in the proposed law.

Exception: Standing of Beneficiary to Contest Revocation

In its follow-up study of the RTODD statute, the Commission recommended adding the following language to Section 5690(a), in order to make clear that a beneficiary has standing to contest the validity of a revocation of an RTODD:

An action to contest the validity of a revocation of a revocable transfer on death deed may be filed by the transferor's personal representative or a beneficiary of the revoked deed under Part 19 (commencing with Section 850) of Division 2. If the contest is successful, the court shall determine the appropriate remedy, which may include revival of the revoked deed. In deciding the remedy, the court shall attempt to effectuate the intentions of the transferor.

The staff recommends that a similar provision be included in the proposed law.

OTHER INSTRUMENTS AND FORMS OF OWNERSHIP

Another general issue that needs to be addressed in this study is the effect of a TOD registration on other instruments or forms of ownership that purport to dispose of the same property on the owner's death. For example, what would happen if a person executes a TOD registration and then later executes a will that purports to dispose of the same property? Similarly, what result if the property affected by a TOD registration is held in joint tenancy form (with a right of survivorship in favor of the other joint owner)?

The RTODD statute provides a good starting point for addressing those issues. It includes four provisions that govern the relationship between an RTODD and a conflicting instrument or form of ownership. Those provisions are set out below for reference, and then discussed in greater detail:

5660. Conflicting dispositive instruments

5660. If a revocable transfer on death deed recorded on or before 60 days after the date it was executed and another instrument both purport to dispose of the same property:

(a) If the other instrument is not recorded before the transferor's death, the revocable transfer on death deed is the operative instrument.

(b) If the other instrument is recorded before the transferor's death and makes a revocable disposition of the property, the later executed of the revocable transfer on death deed or the other instrument is the operative instrument.

(c) If the other instrument is recorded before the transferor's death and makes an irrevocable disposition of the property, the other

instrument and not the revocable transfer on death deed is the operative instrument.

5664. Joint tenancy and community property with right of survivorship

5664. If, at the time of the transferor's death, title to the property described in the revocable transfer on death deed is held in joint tenancy or as community property with right of survivorship, the revocable transfer on death deed is void. The transferor's interest in the property is governed by the right of survivorship and not by the revocable transfer on death deed.

5666. Community property

5666. (a) Chapter 2 (commencing with Section 5010) of Part 1 applies to a revocable transfer on death deed of community property.

(b) For the purpose of application of Chapter 2 (commencing with Section 5010) of Part 1 to a revocable transfer on death deed of community property, written consent to the deed, revocation of written consent to the deed, or modification of the deed, is ineffective unless recorded within the time required by that chapter for execution or service of the written consent, revocation, or modification.

5668. Community property with right of survivorship

5668. A revocable transfer on death deed of community property with right of survivorship is subject to Section 5666, relating to a revocable transfer on death deed of community property.

Conflicting Instruments

Section 5660 provides rules for resolving a conflict between an RTODD and another instrument that purports to transfer the same property on the owner's death. The provisions of that section are discussed separately below.

Off-Record Instrument

Section 5660(a) provides that a recorded instrument controls over an unrecorded instrument.

That rule is based on practical necessity. If an off-record instrument could trump a recorded RTODD, title insurers would have to look beyond the public title records to determine the validity of an RTODD. That would effectively preclude the issuance of title insurance. Without the availability of title insurance, good title would need to be established in court. That would defeat the purpose of the RTODD.

Although recordation and title insurance are not required in every transfer of an interest in a stock cooperative, they may be required where the interest is sold at market rate or purchased with lender financing. In those cases, the title insurer will need to know the universe of instruments that could trump a TOD registration. **To achieve that result, the proposed law should take the same approach as the RTODD statute**, using language along these lines:

If a TOD registration and another instrument both purport to dispose of the same property:

(a) If the other instrument is not recorded before the transferor's death, the TOD registration is the operative instrument.

If the Commission agrees with that general approach, there are two related issues that should be considered:

Recordation Generally. At its December 2020 meeting, the Commission tentatively decided that recordation need not be used as part of the process of authenticating a TOD registration. The process of registration itself, with the involvement of an agent of the stock cooperative, would be sufficient for that purpose.

However, the discussion of conflicting instruments exposes a different reason to require recordation of a TOD registration. As noted, there will be situations in which title insurance is required for the effective transfer or encumbrance of an interest in a stock cooperative (e.g., when an interest that was transferred by TOD registration is later sold at market value). In such a situation, the existence of the TOD registration will need to be indicated in the title records. Otherwise, those records will not correctly reflect the actual status of the interest. **For that reason, the staff recommends that the proposed law require that a TOD registration be recorded.**

Timing. The rule in Section 5660(a) turns on whether a conflicting instrument was recorded *before the transferor's death*. That bright line rule cuts off the possibility that any new conflicting instrument might surface and be given effect. Without such a rule there would never be sufficient certainty in the title records. An instrument that could potentially supersede an RTODD could pop up at any time.

For the same reason, it is important that the proposed law include a clear end to the period during which a conflicting instrument can be recorded and potentially given effect. *However, it is not necessary that the period for recordation end*

at the time of the transferor's death. The law could extend the period to some number of days after the transferor's death.

There would be a significant advantage to such an approach. It would give the transferor's heirs time to look into the transferor's estate, discover the TOD registration, and take steps to record a conflicting interest (thereby preserving the potential effect of the conflicting instrument). This is important because a TOD registration would be a private transaction, involving only the transferor and the stock cooperative. The transferor's heirs might have no idea that a TOD registration exists until after the transferor's death. Allowing recordation of conflicting instruments after the transferor's death would give interested persons a reasonable opportunity to preserve the possible effect of a conflicting instrument.

The main disadvantage to providing for post-death recordation of conflicting instruments is the burden such a rule would place on marketability. During the period in which a conflicting instrument could be recorded, there would be no certainty that the TOD registration would ultimately be given effect. At any time during the recordation period, a conflicting instrument could be recorded, with the potential to supersede the TOD registration. For that reason, title insurers would be reluctant to issue policies during the recordation period.

However, there is an important point to consider, which would effectively negate the disadvantage of an extended post-death period for recordation of conflicting instruments. As emphasized above in the discussion of contests, the RTODD statute already creates a 120-day period of impaired marketability after a transferor's death. That is because the recordation of a *lis pendens* within that 120-day period preserves the possibility that a successful contest will void the RTODD. Because of that, title insurers are unlikely to insure good title until the 120-day period for recording a *lis pendens* has run.

If the Commission decides to take the same approach in the TOD registration study, *there would be no additional impairment of title* if a conflicting instrument could be recorded during the same 120-day period. In other words, if the possibility of a *lis pendens* being recorded is already sufficient to impair marketability for 120 days, then allowing recordation of a conflicting instrument during the same period should not create any additional problem.

For those reasons, the staff recommends that the proposed law allow for recordation of a conflicting instrument for up to 120 days after the transferor's death. Thus:

If a TOD registration and another instrument both purport to dispose of the same property:

(a) If the other instrument is not recorded on or before 120 days after the transferor's death, the TOD registration is the operative instrument.

If the Commission agrees, then there is another possibility that should be considered. **Should the Commission also revise its RTODD follow-up recommendation to include a similar change to the RTODD statute?** In other words, should existing Section 5660(a) be revised as follows:

5660. If a revocable transfer on death deed recorded on or before 60 days after the date it was executed and another instrument both purport to dispose of the same property:

(a) If the other instrument is not recorded before on or before 120 days after the transferor's death, the revocable transfer on death deed is the operative instrument.

A bill to implement the Commission's recommendation on the RTODD statute is currently pending. If the Commission wishes to make the change proposed above, the staff would request that the bill be amended accordingly. It is too late for such a change to be included in the Commission's recommendation in the RTODD follow-up study. That report has already been printed in final form. However, it might be possible to issue a supplemental report that explains the change, perhaps as an appendix to the next Annual Report. If the Commission decides to make such a change, the staff will prepare a memorandum that discusses how to memorialize the decision.

Revocable Instrument

Under Section 5660(b), if an RTODD and another testamentary instrument are both recorded *and the other instrument is revocable*, the later-executed instrument controls. In that situation, both instruments have the same status with respect to practical considerations. Both are of record and can be relied on by title insurers. Both are revocable, so there's no obstacle to setting either aside. In short, from a practical point of view, there is no reason to privilege one over the other.

Instead, Section 5660(b) provides that the later-executed instrument controls. This increases the likelihood that the transferor's intentions will be effectuated. As a default rule, it is reasonable to assume that the transferor's most recent act is the best evidence of the transferor's intent just prior to death.

The staff recommends that the proposed law include a similar rule. As between instruments that are similarly situated with respect to practical concerns (i.e., both are revocable and of record), the later executed should be given effect.

Irrevocable Instrument

Section 5660(c) provides that an irrevocable instrument (e.g., an irrevocable trust) controls over an RTODD, if both are recorded. Here, both instruments have the same status with respect to recordation. However, the irrevocability of the competing instrument introduces a new practical consideration. By executing an irrevocable instrument that transfers the property on death, the transferor has effectively surrendered the power to make any other disposition of that property. For that reason, the irrevocable instrument controls.

The staff recommends that the same rule should apply in the proposed law. As between recorded instruments, an irrevocable testamentary instrument should prevail over a TOD registration affecting the same property.

Right of Survivorship

There are two forms of ownership of real property that include a right of survivorship: (1) joint tenancy and (2) community property with a right of survivorship.⁴ Title insurers should be able to determine both of the following simply by referring to the county title records:

- The existence of an RTODD.
- Ownership in a form that confers a right of survivorship.

There is thus no *practical* reason why either form of nonprobate transfer on death should be preferred over the other, when resolving a conflict between them.

This means that the proposed law's treatment of the matter should be based on the transferor's most likely intentions, if possible. Reasonable minds can differ on whether a transferor would prefer that the TOD registration or the right of survivorship control. When developing the RTODD statute, the Commission concluded that an RTODD should prevail over a right of survivorship.

That was one of the handful of policy recommendations that the Legislature specifically rejected. Section 5664 was amended to reverse the Commission's

4. When property is jointly owned, with a right of survivorship, the death of any joint owner results in that owner's interest being automatically assumed by the surviving joint owners.

proposed rule, providing instead that ownership in joint form with a right of survivorship would void an RTODD.

The staff recommends that the Commission respect the Legislature's judgment on that point. Under the proposed law, joint ownership survivorship should prevail over a TOD registration.

Spousal Consent to Nonprobate Transfer of Community Property

Under existing law, a nonprobate transfer of community property is not effective unless the transferor's spouse has consented to the transfer.⁵

The RTODD statute makes clear that the same general rules apply to an RTODD.⁶ That is merely a clarifying expression of general law, rather than a new rule specific to an RTODD (i.e., the result would be the same whether the RTODD addressed the matter or not). **The staff recommends that the same clarification be provided in the proposed law, making clear that the spousal consent requirements of general law must be satisfied.**

NEXT STEP

Once the Commission has decided the questions presented in this memorandum, the staff will prepare a draft of a tentative recommendation for the Commission's consideration.

Respectfully submitted,

Brian Hebert
Executive Director

5. See Sections 5010-5032.

6. Sections 5666, 5668.